IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 420 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INOCME TAX

Versus

SUHASHBHAI VADILAL

Appearance:

MR B.B.NAIK with MR MANISH R BHATT for Petitioner

MR JP SHAH for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE A.R.DAVE

Date of decision: 21/09/98

ORAL JUDGEMENT (Per R.K.Abichandani,J.)

The Income Tax Appellate Tribunal has referred the following question for the opinion of this Court under Section 256(1) of the Income Tax Act, 1961.

"Whether on the facts and in the circumstances of

the case, the Tribunal was right in law in coming to the conclusion that the order passed by the Commissioner of Income Tax under Section 263 was liable to be vacated in so far as it related to the method of working out the cost of the share of Rajesh Textile Mills Limited ?"

2. In the relevant Assessment Year 1975-76, the assessee sold 500 shares of Rajesh Textile Mills Limited for Rs. 51,125 against the cost price of Rs. 1,04,375 claiming loss of Rs. 53,250, which was allowed by the Income Tax Officer. The CIT (Appeals) however, by his order passed under Section 263 of the said Act, rejected the assessee's claim as regards the sale of shares in Rajesh Textile Mills Limited, that as the shares in Rajesh Textile Mills Limited were received as right shares on the holding of shares in Sayaji Mills Limited, the cost of shares of Rajesh Textile Mills Limited was the cost of such shares plus depreciation in the value of shares of Sayaji Mills Limited at the rate of Rs. 108.75 paise per share. The CIT drew distinction between the cost of shares of Rajesh Textile Mills Limited to the assessee and the cost of similar such shares to his father, whose similar claim was earlier allowed, by saying that while the assessee's father had sold the shares immediately, the assessee had held on the shares of Rajesh Textile Mills Limited for 12 years and therefore, in his case the cost would be different.

The Tribunal held that the cost of the shares of Rajesh Textile Mills Ltd., which the assessee acquired, got fixed at the point of acquisition and it was irrelevant when the shares were sold. The Tribunal relied upon the earlier decision dated 6.1.1982 of the Tribunal in the case of the assessee's father as well as it's decision dated 6.1.1982 in ITO Vs. Suhashbhai Vadilal Family Trust for the Assessment Year 1980-81.

3.(i) Certain aspects of the case which are not disputed and which emerge from the record are that the company known as Sayaji Mills Limited passed a resolution on 6th June, 1961 at the meeting of the Board of Directors resolving that an extra-ordinary general meeting of the share-holders of that company be convened on 12th July, 1961 to accord consent to the Board of Directors of the company for selling to the new company proposed to be registered under the name of "Rajesh Textile Mills Limited", the entire unit of the company located in Bombay known as "Sayaji Mills No.2" at the price and on the terms and conditions contained in the draft agreement of sale placed before the Board. It was

also resolved that the Managing Directors were authorised and directed to take all the steps for the formation of the purchasing company and to pay for the time being out of the funds of Sayaji Mills Limited all expenses for the proposed company. In the extra-ordinary general meeting which was held on 12th July, 1961 of the Sayaji Mills Limited, the draft agreement for sale of the unit known as "Sayaji Mills No.2" to the new company i.e. Rajesh Textile Mills Limited, was approved and the Directors were authorised to complete the sale.

(ii) On 6th August, 1961, the Board of Directors of Rajesh Textile Mills Limited being the new company which came into existence, made a resolution in respect of the application made to Controller of Capital Issue, seeking his consent to the issue of 50,000 equity shares to the share-holders of Sayaji Mills Limited in connection with the purchase of it's unit i.e. Sayaji Mills No.2. It was resolved that, "50,000 equity shares of the face value of Rs. 100 each be offered to the holders of equity shares of Sayaji Mills Limited appearing on the register of members of that company on 21st day of August, 1961 in the proportion of one such share of that company held by such member and that the sum of Rs. 100 should be required to be paid in respect of each such share applied for with the application, subject to the terms of the consent order of the Controller of Capital Issue when received". Admittedly, the consent of the Central Government was obtained in respect of the issuance of the share capital of Rajesh Textile Mills Limited as per its application and the share-holders of Sayaji Mills Limited became entitled to get the shares of Rajesh Textile Mills Limited in the ratio of 1:1.

(iii) One other admitted fact which emanates from the record is that Rajesh Textile Mills Limited issued letters on 8th August, 1961 to various share-holders of Sayaji Mills Limited in accordance with it's resolution, which entitled them to get the shares of Rajesh Textile Mills Limited in proportion to their holding in Sayaji Mills Limited. The shares of Sayaji Mills Limited were quoted in the Stock Exchange and from the list maintained by the Stock Exchange, it was brought on record that the shares of Sayaji Mills Limited were quoted at Rs. 543.75 paise each as on 18th August, 1961. This position continued upto 22nd August, 1961. However, on 15th September, 1961, the value of shares of Sayaji Mills Limited came down to Rs. 410 (Ex-right cum dividend), when the right to receive the shares of Rajesh Textile Mills Limited which is described in the record as "Ex-right", was realised. Though stricto-senso, the

"right issue" would relate to the issue by a company of such shares to its own share-holders, the expression has been used in the present case by the authorities including the Tribunal to describe the right attached to the shares of Sayaji Mills Limited to receive the shares of Rajesh Textile Mills Limited, in view of the special arrangement made between the companies. After the right issue, the shares of Sayaji Mills Limited without any right to get the shares of Rajesh Textile Mills Limited depreciated. It is an admitted fact that there was a fall of Rs. 108.75 paise in the price of a share of Sayaji Mills Limited, being the difference between it's quotation as on the date when it carried the right to receive a share of Rajesh Textile Mills Limited, and later on when it ceased to carry such right.

4. The present assessee had sold 500 shares of Rajesh Textile Mills Limited, which he had acquired in view of the above arrangement against his holding in Sayaji Mills Limited for Rs. 51,125/- in the Assessment Year 1975-76. While calculating the cost price of these 500 shares, he added to the face value of Rs. 50,000/being the amount at which they were offered to him as a share-holder of Sayaji Mills Limited, the depreciation in the value of his shares in Sayaji Mills Limited, which was, as aforesaid Rs. 108.75 paise when the shares came to be sold without the right to receive the shares of Rajesh Textile Mills Limited. The assessee accordingly, claimed a loss of Rs. 53,250/-.

5. Earlier, in the Assessment Year 1962-63, in context of similar such shares of Rajesh Textile Mills Limited being sold by the assessee's father (who had on 22.2.1962 sold 2450 shares of Rajesh Textile Mills Ltd. at Rs. 200/- per share), the question had arisen before the Tribunal in the Income Tax proceedings for the Assessment Year 1962-63 as to whether the assessee could claim capital loss or depreciation on account of the fall in the value of the shares of Sayaji Mills Limited, amounting to Rs. 108.75 paise per share. At that time, the assessee had contended relying upon the ratio of the decision of the Hon'ble Supreme Court in the case of Miss Dhun Dadabhoy Kapadia Vs. C.I.T, reported in 63 I.T.R 651 that the fall in the value of shares of Sayaji Mills Limited was directly linked with the issue of shares in Rajesh Textile Mills Limited. It was contended that the fall in the price of shares of Sayaji Mills Limited was closely linked with the issuance of shares of Rajesh Textile Mills Limited and the entire arrangement was a part of the same transaction. The Tribunal held that the fall in the value of shares of Sayaji Mills Limited was a

direct result of the issue of shares of Rajesh Textile Mills Limited. It was held that the sale of Sayaji Mills No.2 being a unit of Sayaji Mills Limited to Rajesh Textile Mills Limited and the decision to issue shares in the new company to the share-holders of Sayaji Mills Limited and the consequent fall in the shares of Sayaji Mills Limited were all closely integrated and inter-connected matters. It was noted that the Revenue did not appear to have disputed that fact before the authorities. The Tribunal applying the ratio of the decision in the case of Dhun Dadabhoy Kapadia (supra) held that the net capital gain by the assessee in the transaction consisted of new shares i.e. the shares in Rajesh Textile Mills Limited minus the difference between the value of the shares of Sayaji Mills Limited before obtaining the new shares in Rajesh Textile Mills Limited and the value of shares of Sayaji Mills Limited after the issue of such new shares. It was held that in the alternative, the assessee was entitled to deduct the depreciation in the value of shares of Sayaji Mills Limited as per the ratio of the decision of the Supreme Court in Dhun Dadabhoy Kapadia's case (supra). The Tribunal, in that case, also considered the contention that the ratio of Dhun Dadabhoy Kapadia's case will not apply in a case where the new shares purchased are not the right issue of the same company. It was observed by the Tribunal that the Hon'ble Supreme Court in the case of Dhun Dadabhoy Kapadia (supra) was considering the transaction as a whole in order to arrive at the net capital gain and the only thing that was relevant was whether the right to receive the shares was depending upon the holding of shares whether it be in one company or of two different companies. It was held that the ratio of the decision in Dhun Dadabhoy Kapadia (supra) was fully applicable to the case of the assessee (who was the father of the present assessee).

The aforesaid reasoning of the Tribunal in it's order dated 6.1.1973, which was made in a similar case of the present assessee's father in respect of the Assessment Year 1962-63 and which is not shown to have been challenged, was followed in the present assessee's case by the Tribunal in it's order from which the aforesaid question has arisen and that is why we have set out the reasons which had weighed with the Tribunal in the case of the assessee's father.

6. Under Section 45 of the said Act, any profits or gains arising from the transfer of a capital asset effected in the previous year was chargeable to income-tax under the head "capital gains" and would be

deemed to be the income of the previous year in which the transfer took place, save as otherwise provided in the provisions mentioned therein. The mode of computation and deductions for the purpose of working out capital gains is laid down in Section 48, as per which the expenditure incurred wholly and exclusively in connection with such transfer as well as the cost of acquisition of the capital asset and the cost of any improvement thereto is required to be deducted from the full value of the consideration received or accruing as a result of transfer of capital asset. The question therefore is as to what was the cost of acquisition of the shares of Rajesh Textile Mills Limited, which were acquired by the assessee by virtue of his holding the shares of Sayaji Mills Limited, in view of the arrangements made between the two companies and the resolutions passed by them, which entitled the share-holders of Sayaji Mills Limited to a right to get the shares of Rajesh Textile Mills Limited. Eventhough the shares of Rajesh Textile Mills Limited could not be described as "right issue" properly so-called, yet the fact remained that by virtue of the arrangements made between the two companies, share-holders of Sayaji Mills Limited became entitled to get shares of Rajesh Textile Mills Limited in the proportion of 1:1 as resolved and offered by Rajesh Textile Mills Limited, in favour of the share-holders of Sayaji Mills Limited. Therefore, in context of the right of getting the shares of Rajesh Textile Mills Limited, the share-holders of Sayaji Mills Limited stood on the same footing as they would stand in getting any right issue of their own company which would have effect on the value of their holding in the Sayaji Mills Limited. In other words, the shares in Sayaji Mills Limited with a right to acquire the shares in Rajesh Textile Mills Limited would have a different market value than their market value at a point where the shares of Sayaji Mills Limited did not carry such right to receive the shares of Rajesh Textile Mills Limited. This precisely is the difference that occurred and was quantified at Rs. 108.75 paise at the relevant time reflecting the difference between the value of the shares of Sayaji Mills Limited, soon after the resolution was made by Rajesh Textile Mills Limited of offering their shares as a matter of right to the share-holders of Sayaji Mills Limited, which resulted in the higher price of shares of Sayaji Mills Limited quoted at Rs. 543.75 paise, which fell to Rs. 410/- Ex-right cum dividend, when quoted without such right. This fluctuation in view of the arrangements between the companies and in the peculiar facts of the case was similar to that which would occur when the right shares of the same company of which the

shares are held, are issued.

7. In Dhun Dadabhoy Kapadia's case (supra) the Supreme Court while dealing with a matter where the assessee had renounced her right to get the new shares for a price, held that the assessee could exercise her right by actually purchasing the shares at the prescribed rate or by renouncing the same in favour of another person and obtaining monetary gain in that transaction. At the time when the assessee renounced her right to take the new shares, the capital asset which she actually possessed consisted of her existing holding plus the right to take the new shares and this would mean that at the time of transaction the value of her old shares plus the right to obtain new shares, together constituted the capital asset. After the right was transferred, the capital asset in the hands of the assessee would be the old shares, the value of which had fallen together with the amount realised on transfer of her right. The Supreme Court held that the net capital gain or loss to the assessee obviously would be the difference between the value of the capital asset and the cash in her hands after she had renounced her right and realised the cash value in respect of it, and the value of the capital asset including the right which she possessed just before the new shares were issued and before she realised any cash in respect of the right by renouncing it in favour of some other person. It was further held by the Supreme Court, while examining the case from an alternative angle, that the value of the right may be measured by setting off against the appreciation in the face value of the new shares, the depreciation in the old shares and, consequently, to the extent of the depreciation in the value of her original shares, she must have been deemed to have invested money in acquisition of this new right. A concomitant of the acquisition of the new right was the depreciation in the value of the old shares, and the depreciation may in a commercial sense, be deemed to be the value of the right which she subsequently transferred. The capital gain made by her would, therefore, be represented only by the difference between the money realised on transfer of the right, and the amount which she lost in the form of depreciation of her original shares in order to acquire that right. Thus, the net capital gain by the assessee would be represented by the amount realised on transferring the right to receive new shares after deducting therefrom the amount of depreciation in the value of her original shares, being the loss incurred by her in her capital asset in the transaction in which she acquired the right for which she realised the cash.

The learned Counsel appearing for the Revenue however, argued that the ratio of the decision of the Supreme Court in Dhun Dadabhoy Kapadia's case (supra) cannot be invoked by the present assessee because in the present case, the right issue was of shares belonging to a different company. This distinction though apparently attractive, falls to the ground when we take note of the admitted fact that in view of the special arrangement made between the newly formed company of Rajesh Textile Mills Limited and Sayaji Mills Limited, a situation was brought about whereby the share-holders of Sayaji Mills Limited became entitled to receive as a matter of right in the proportion of 1:1, the shares of Rajesh Textile Mills Limited. It is the entitlement to receive the shares of Rajesh Textile Mills Limited that clearly had an impact on the value of the shares of Sayaji Mills Limited. This peculiar nexus which was established by the two companies brought about a fact situation akin to what would happen when a company issues shares in favour of its own share-holders by way of right issue.

8. The next contention of the learned Counsel for the Revenue was that the shares issued by Rajesh Textile Mills Limited could have had no effect on the financial position of Sayaji Mills Limited. What is important in the present case is to ascertain the cost of acquisition of the shares of Rajesh Textile Mills Limited acquired by the assessee by virtue of his holding in the Sayaji Mills Limited. The entitlement was fixed in the ratio of 1:1 and this got attached with the value of shares of Sayaji Mills Limited, which fluctuated between the two points namely - at the point when the shares of Sayaji Mills Limited started to carry with them the right to receive the shares of Rajesh Textile Mills Limited and the other point at which they ceased to carry that right. This situation was real, and on the ratio of the decision in the case of Dhun Dadabhoy Kapadia (supra) would constitute an important and relevant base for ascertaining the cost of acquisition of the shares of Rajesh Textile Mills Limited by the assessee, who not only paid the price for which they were offered but also suffered the depreciation in the value of shares of Sayaji Mills Limited at Rs. 108.75 paise being the difference between the aforesaid two points namely the value of Sayaji Mills's share when it carried the right and later when it ceased to carry the right. Therefore, the contention of the learned Counsel for the Revenue cannot be accepted.

9. It was also contended that at the relevant time

Sayaji Mills Limited had transferred one of it's units to Rajesh Textile Mills Limited and that may have caused the fall in the value of shares of Sayaji Mills Limited. That is nobody's case so far and as can be seen from the order of the Tribunal in the case of assessee's father on which reliance is placed by the Tribunal in it's present order passed in case of the assessee, there was absolutely no dispute over the fact that the fall in the value of shares of Sayaji Mills Limited was a direct result of the issue of shares of Rajesh Textile Mills Limited, as recorded in paragraph 3 of the order of the Tribunal which was made on 6.1.1973 in a similar case of assessee's father and which reasoning has been adopted by the Tribunal in the assessee's case. Therefore, the contention now raised on behalf of the Revenue of this nature cannot be countenanced.

10. The learned Counsel appearing for the Revenue then finally argued that if the transaction of transferring the right shares of Rajesh Textile Mills Limited had taken place around the time when they were issued, then alone the ratio of the decision of the Supreme Court in Dhun Dadabhoy Kapadia's case (supra) could be invoked. However, since the shares of right issue have been sold after a lapse of 12 years by the assessee, the ratio of that decision will not apply because by passage of time the temporary impact on the shares of Sayaji Mills Limited by issue of the shares of Rajesh Textile Mills Limited would be wiped off. We do not think this is the way in which one should assess the cost of acquisition of the shares. The cost of the acquisition of the shares of Rajesh Textile Mills by the assessee crystalised itself when the amount at which they were offered was paid and the depreciation in the holding of the assessee in respect of shares of Sayaji Mills Limited with which the new shares were directly attached in the ratio of 1:1 was suffered at the rate of Rs. 108.75 paise by the assessee. As held by the Supreme Court in Dhun Dadabhoy Kapadia's case the value of the right may be measured by setting off against the appreciation in the face value of the new shares the depreciation in the old shares and consequently to the extent of depreciation in the value of the old shares the assessee must be deemed to have invested money in acquisition of the new right. The capital gain by the assessee was therefore, the money realised on the transfer of the shares of Rajesh Textile Mills Limited minus the amount paid by him for those shares as well as the amount lost in the form of depreciation of his shares in Sayaji Mills Limited in order to acquire the shares of Rajesh Textile Mills Limited. The real question is as to

what was the cost of acquisition of the share of Rajesh Textile Mills Limited to the assessee. Was it mere Rs. 100 per share or more. The evidence shows that the shares in Rajesh Textile Mills Limited were given to the share-holders of Sayaji Mills Limited as a matter of right, depending upon their holding and at the ratio of 1:1. Though they were not right issues properly so-called of Sayaji Mills Limited, the fact remains that the shares of Sayaji Mills Limited carried with them right to receive the share of Rajesh Textile Mills Limited in view of the special arrangement made between the two companies and the resolution passed by Rajesh Textile Mills Limited linking its issue directly with the holding of the shares in Sayaji Mills Limited. When this right to receive the shares of Rajesh Textile Mills Limited went with the shares of Sayaji Mills Limited, their value was Rs. 543.75 per share, but soon after shares of Rajesh Textile Mills Limited were issued, the value of shares of Sayaji Mills Limited which thus followed, carried with right diminished to Rs. 410/- per share. The depreciation in value of share of Sayaji Mills Limited to the extent of Rs. 108.75 paise was directly related to the issuance of shares by Rajesh Textile Mills and that depreciation was the amount lost to the assessee in acquiring the new shares of Rajesh Textile Mills Limited. To the extent of this depreciation which in the instant case was Rs. 108.75 paise as per the fact found, the assessee must be deemed to have invested money in the acquisition of the shares of Rajesh Textile Mills Limited. Therefore, the cost of acquisition having been so crystallised the passage of time when these new shares were sold, would not make the difference in that cost.

We are therefore of the view that the assessee was entitled to claim deduction of the amount of depreciation in the value of his shares in Sayaji Mills Limited being the loss incurred by him in his capital asset in the transaction in which he acquired the shares in Rajesh Textile Mills Limited. The Tribunal therefore, rightly held that as the shares in Rajesh Textile Mills were received as a matter of right on the holding of the shares in Sayaji Mills Limited by the assessee, the cost of shares of Rajesh Textile Mills Limited was the price that was paid for such shares plus the depreciation in the value of such shares of Sayaji Mills Limited (against which they were issued) at the rate of Rs. 108.75 paise per share. The question referred to us is therefore, answered in the affirmative against the Revenue and in favour of the assessee. The reference stands disposed of

accordingly with no order as to costs.

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